REBUTTAL TESTIMONY OF
ALISON M. NAWROCKI
ON BEHALF OF
DOMINION ENERGY SOUTH CAROLINA, INC.
DOCKET NO. 2020-125-E

INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Alison Nawrocki. My business address is 707 E. Main Street, Richmond, Virginia 23219.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am Controller-Tax for Dominion Energy Services, Inc.

Q. PLEASE DESCRIBE YOUR CURRENT RESPONSIBILITIES AT DOMINION ENERGY SERVICES, INC.

A. I oversee the income and non-income tax compliance functions for Dominion Energy subsidiaries. My team is responsible for tax return preparation and financial accounting for taxes.

Q. ON WHOSE BEHALF ARE YOU SUBMITTING THIS TESTIMONY?

A. I am submitting this testimony on behalf Dominion Energy South Carolina, Inc. ("DESC" or the "Company") in support of its Notice of Change and Application for Increase in Rates and Charges.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL BACKGROUND.

A. Since 2001, I have worked in the tax group at Dominion Energy Services, Inc. in various roles. I am licensed as a Certified Public Accountant in Virginia.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.

A. I earned a B.B.A. in Accounting and a Masters in Accounting (MAcc) from the University of Wisconsin-Madison.

Q. HAVE YOU TESTIFIED IN REGULATORY PROCEEDINGS?

A. No, I have not previously testified in regulatory proceedings.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to respond to certain aspects of the direct testimony of Mark E. Garrett filed on behalf of the United States Department of Defense and All Other Federal Executive Agencies ("DOD-FEA") and the direct testimony of Lane Kollen filed on behalf of the South Carolina Office of Regulatory Staff. I will focus first on Mr. Garrett's proposal to amortize "unprotected" plant-related excess deferred income taxes over a five-year period and then respond to certain aspects of the direct testimony of Lane Kollen.

EXCESS DEFERRED INCOME TAXES

Q. WHAT ARE EXCESS DEFERRED INCOME TAXES ("EDIT")?

A. In years between 1988 and 2017, when DESC claimed (and was able to use) certain tax deductions in excess of its corresponding book expenses – most particularly accelerated (including bonus) tax depreciation - it deferred its income tax liability by an amount equal to the excess of the tax deduction over the corresponding book expense multiplied by the corporate tax rate (34 or 35%, depending on the year). The cash benefit of the income tax deferral was retained by DESC, recorded as accumulated deferred income taxes ("ADIT") and reflected in ratemaking as an offset to rate base. It was anticipated that the amount of the deferral would eventually have to be paid back to the government in the form of higher income taxes when, later on in the life of the depreciable assets, book depreciation would exceed the available tax depreciation deductions. However, the reduction in the income tax rate enacted as part of the Tax Cuts and Jobs Act of 2017 ("TCJA") altered the amount of the anticipated repayment liability. When, eventually, the higher taxable income is produced, it will be taxed at 21%, not 34 or 35%. Consequently, some portion of the ADIT reserve previously recorded on the presumption that it would be taxed at 34 or 35% is rendered unnecessary for that purpose. This portion is EDIT.

Q. CAN THIS EDIT BE FLOWED THROUGH TO CUSTOMERS?

A. Yes, it can be, though the timing of the flow through of some of the amount is restricted by the tax law.

Q. PLEASE EXPLAIN.

A. Section 13001 of the TCJA establishes a rule that is very similar to the one established in the Tax Reform Act of 1986 when the corporate income tax rate was reduced from 46% to 34%. Specifically, that section defines the term "excess tax reserve" as the excess of the ADIT reserve required by the normalization rules (that is, the ADIT reserve that is attributable to accelerated depreciation) as of the day prior to the TCJA tax rate reduction over the amount that would have been in that reserve had the new lower corporate tax rate been in effect for all prior periods. The "excess tax reserve" (which I will refer to hereafter as "protected" EDIT) can be flowed through to customers no faster than as the underlying timing differences reverse using the Average Rate Assumption Method ("ARAM") or, if the utility doesn't have the records necessary to apply the ARAM, ratably over the remaining life of the property.

Q. IS THERE ANY RESTRICTION IN THE TAX LAW ON THE TIMING OF FLOWING TO CUSTOMERS ANY OF THE REMAINDER OF THE EDIT BALANCE?

A. No, there is not. The flow through of those amounts (which I will refer to hereafter as "unprotected" EDIT) can occur at whatever rate the regulator deems reasonable and appropriate.

Q. HOW IS DESC TREATING ITS EDIT BALANCE IN RATES?

A. DESC has segregated its EDIT into two categories – plant-related EDIT and all other EDIT. The amortization of EDIT was addressed previously in the merger Order No. 2018-804 and should not be reopened now. In that case, the Commission ruled that they agreed with DESC's approach to amortize all plant-related EDIT (protected and unprotected) in accordance with the ARAM. See Order No. 2018-804, page 53-54. Consistent with that order, DESC is treating all plant-related EDIT the same, whether or not it is protected. The timing of the provision of this EDIT to customers is governed by the ARAM. With respect to all other EDIT, DESC is amortizing the benefits to customers over 5 years, starting in 2018.

Q. WHY DID DESC PROPOSE TREATING EDIT THIS WAY?

A. As articulated in the in the merger case by tax expert Jim Warren, DESC proposed using the same amortization period (the remaining life of the plant) for all plant-related ADIT for uniformity, ease of administration and sound regulatory economics. Further, as explained below, DESC's approach better matches the benefits of EDIT flowback with the customer funding of plant assets.

Q. WHAT DOES MR. GARRETT RECOMMEND WITH RESPECT TO THE COMPANY'S EDIT?

A. Mr. Garrett recommends that the ARAM be applied only to the "protected" EDIT and that the remainder of the DESC's EDIT be flowed to customers over five years.

Q. AS A THRESHOLD MATTER, DOES MR. GARRETT AGREE WITH THE COMPANY REGARDING THE TREATMENT OF PROTECTED EDIT?

A. Yes, he does. I believe both parties agree that the provision of this portion of DESC's EDIT to customers must be governed by the ARAM in order to comply with the tax law.

Q. DOES MR. GARRETT'S APPROACH ACHIEVE A FAIR BALANCE AMONG GENERATIONS OF CUSTOMERS?

A. No, it does not. His recommendation does not provide the EDIT to customers in later years who are paying for plant costs through depreciation expense.

Q. PLEASE PROVIDE AN EXAMPLE THAT ILLUSTRATES THIS.

A. Assume that Utility X acquires a $1,000,000 asset in Year 1 that is depreciable over twenty-five years for regulatory purposes and, for tax purposes, is deductible in its entirety as a repair in the year of acquisition. Further assume that the income tax rate in Year 1 is 35% and that in Year 2 the tax rate is reduced to 21%. Such an asset would produce $336,000 of ADIT in Year 1 ($1,000,000 tax depreciation less $40,000 book depreciation multiplied by 35%). At the beginning of Year 2, $134,400 ($336,000 X 40%) of that ADIT would become EDIT as a result of the tax rate reduction.

Q. HOW MUCH DEPRECIATION WOULD YEAR 1 CUSTOMERS FUND?

A. Year 1 customers would fund $40,000 ($1,000,000/25) of depreciation, the same amount that would be funded by customers in Years 2 through 25.

Q. UNDER MR. GARRETT'S RECOMMENDATION, HOW MUCH EDIT WOULD HE FLOW TO CUSTOMERS ANNUALLY IN YEARS 2 THROUGH 6?

A. $26,880 each year ($134,400/5). This would reduce rates in each of those years by approximately $34,025 ($26,880/(1-21%)). So as a result of the asset being used in Year 1, the Year 2 through Year 6 customers would end up paying about $5,975 per year (the $40,000 of funded depreciation less the tax benefit of $34,025) for the use of the asset.

Q. WHAT IS THE EFFECT OF MR. GARRETT'S APPROACH?

A. Mr. Garrett would deny any EDIT benefit of the tax rate reduction to nineteen years' worth of customers – all of whom pay the exact same amount in depreciation ($40,000) with respect to the exact same asset as was paid by customers in Year 1 through Year 6, but will receive no benefit of the EDIT.

Q. DOES THIS ACHIEVE INTERGENERATIONAL EQUITY?

A. No, it does not. I believe that intergenerational equity is better achieved by allocating the EDIT to all the customers that will pay for and support the depreciable asset over its twenty-five-year life. This is true of plant that produced protected EDIT and equally true of plant that produced unprotected EDIT. It is for this reason that the Merger Order's approach to apply the ARAM to all plant-related ADIT is a more equitable and reasonable approach. Tax rates could increase or decrease over the regulatory life of the underlying property so any resulting change to the EDIT balance – positive or negative – should be amortized over the remaining life of that property.

Q. IS THERE AN INDIRECT RATE IMPACT OF AMORTIZING EDIT?

A. Yes, there is. EDIT, like the ADIT it was before the income tax rate reduction, represents cost-free capital. It therefore was, and continues to be, treated as a reduction to rate base. Customers continue to benefit from the presence of unamortized EDIT through this rate base reduction. Conversely, the amortization of EDIT will reduce DESC's stock of cost-free capital. This necessarily results in an increase in rate base. It is not that EDIT should not be amortized. However, until it is, customers continue to derive an indirect, but important, rate benefit.

Q. TURNING TO MR. KOLLEN'S TESTIMONY, WOULD YOU DISCUSS YOUR VIEWS ABOUT THE CONCEPTS HE ESPOUSES RELATED TO UNPROTECTED EDIT?

A. Yes. In his testimony, Mr. Kollen suggests that the Commission revisit the amortization period for property-related unprotected EDIT and adopt a five-year amortization period for the remaining balance of these EDIT regulatory liabilities starting on the date that base rates are reset in this proceeding. For the reasons outlined above in response to Mr. Garrett's testimony and consistent with the Commission's order in the merger case, DESC holds the view that using the same amortization period (the remaining life of the plant) for all plant-related EDIT is most appropriate method to ensure uniformity, ease of administration and sound regulatory economics.

While DESC opposes the change, if the Commission were to agree with Mr. Garrett's and Mr. Kollen's proposals for a five-year amortization period on plant-related unprotected EDIT, additional work would need to be done to reach a consensus on the appropriate amount of such adjustment. Mr. Garrett and Mr. Kollen have computed two different numbers and it is not immediately clear to DESC how either of the computations were performed.

Q. DOES MR. KOLLEN PROPOSE AN ADJUSTMENT TO RATE BASE TO ACCOUNT FOR THE IMPACT OF A CHANGE IN EDIT AMORTIZATION?

A. No. Mr. Kollen indicates that he has not included an increase in rate base in his computation for the effect of shortening the amortization period for unprotected plant-related EDIT and states that he did not do so because he did not believe DESC had done so in their computations (Kollen, page 52, lines 10-16). Mr. Kollen's assertion that DESC did not include an increase in rate base for the amount of EDIT amortization recorded is incorrect. As described above, EDIT, like all deferred taxes is a form of cost-free capital, and as such, is a reduction to rate base. Conversely, as the amortization of EDIT was recorded and deferred tax liabilities were reduced, it drove an increase in rate base.

Q. DO YOU HAVE ANY ADDITIONAL COMMENTS ON MR. KOLLEN'S TESTIMONY?

A. Yes. Mr. Kollen addresses DESC's utilization of the net operating loss ("NOL") carryforward in 2019 and the computations of Capital Cost Rider ("CCR") revenue requirements. Mr. Kollen recommends that the

Commission revise the calculation of the CCR for the months February through December 2019 related to the timing of the NOL carryforward utilized and the related NOL ADIT and EDIT amortizations. Mr. Kollen indicates that his recommendation has the effect of reducing the CCR revenue requirement for those eleven months in 2019 and should reverse $2.027 million of the NND regulatory liability amortized in 2019, see Kollen, page 28, line 21. I agree conceptually with Mr. Kollen that an adjustment is needed to reflect NOL utilization from February through December 2019. I will point out, however, that the proposed adjustment is specific to the CCR, which was excluded when calculating the retail electric revenue requirement in this proceeding. Therefore, while this adjustment to the Company's books and records will reduce CCR revenue and change the timing of the regulatory liability amortization, it will not impact billed retail rates under the CCR.

CONCLUSION

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes, it does.